

Recent Decisions In The United States

A recurring feature

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PROSPECTIVE LICENSEES OF A PACKAGE OF ESSENTIAL AND NON-ESSENTIAL PATENTS DO NOT NEED TO BE OFFERED THE OPTION OF LICENSING INDIVIDUAL PATENTS AT A LOWER RATE

A patent can be rendered unenforceable if the patent owner misuses the power of the patent to obtain a benefit that impermissibly expands the scope of the patent. Examples of patent misuse include requiring a licensee to pay a royalty on products that are not covered by the patent, requiring a licensee to pay royalties after the patent expires, or requiring a licensee to purchase a separate staple product as a condition for the patent license when the patent owner has market power.

In *U.S. Philips Corp. v. ITC*, No. 04-1361 (Sept. 21, 2005), the Court of Appeals for the Federal Circuit held that the patents in Philips' CD-R and CD-RW licensing program were not unenforceable due to Philips' licensing practices.

Philips owns several patents relating to the manufacture of CD-R and CD-RW discs. Philips licensed its patents in a package, charging the same rate regardless of how many patents were actually used. Included in Philips package license were patents that were essential to practicing the CD-R or CD-RW standard and patents that were not essential to that standard. The International Trade Commission ("ITC") had ruled that Philips, licensing program constituted patent misuse because Philips did not give prospective licensees the option of licensing individual patents at a lower rate, particularly because the package included both essential and non-essential patents. Philips appealed this holding to the Federal Circuit.

On appeal, the Federal Circuit first analyzed whether Philips' licensing practices were among those that the courts have identified as so clearly anticompetitive as to warrant being condemned as per se illegal, i.e., per se patent misuse. In this regard, the court began by distinguishing Philips' licensing practice from those previously found by the courts to be per se violations, such as block booking of movies. The court noted that while Philips licenses the patents in a package, it does not require the licensee to use any of the patents in the package. In block booking, however, exhibitors were required to show the movies that they did not want in order to air the movies they wanted.

Next, the Federal Circuit distinguished Philips' licensing program from the unlawful tying of a patent license to an obligation to purchase a product. In those cases, the patent owner uses the market power conferred by a patent to compel purchasers to purchase a product in a separate market that the customer might otherwise purchase from a competitor. The court stated that the licenses granted by Philips, on the other hand, were nothing more than a promise not to sue for infringement and that the conveyance of such a license created no obligation to use the licensed technology. Therefore, the licensing of essential and non-essential patents together did not bar the licensee from using any competing technology. It merely put the competitor in the same position he would be in if he were competing with unpatented technology.

In addition, the Federal Circuit noted that the ITC's decision was based on the incorrect assumption that a license to fewer than all the patents in a package would carry a lower fee. The Court stated that, in reality, the value of any patent package is based largely, if not entirely, on the essential patents. Therefore, it is logical that those non-essential patents are assigned little, if no value. Therefore, in the Court's view licensing the non-essential patents for free along with essential patents was "no more anticompetitive than if it had surrendered the nonessential patents or had simply announced a policy that it would not enforce them."

The Court also noted that package licensing provides several pro-competitive benefits. Specifically, it reduced transaction costs by eliminating the need for multiple contracts, and also obviated any potential future patent disputes between a licensor and licensee. In addition, licensing an entire package allows the parties to price the package based on the particular technology, which is much easier to calculate than the value of individual patents. Therefore, for all these reasons, the Federal Circuit held that the package licensing was not per se patent misuse.

As an alternative ground, the Federal Circuit also analyzed whether there were any commercially viable alternatives to the technology covered by the alleged nonessential patents. The Federal Circuit stated that if there were no commercially viable alternatives, then the packaging of essential and nonessential patents could have no anticompetitive effect. The court concluded that the

evidence did not establish that there were any viable commercial alternatives, and therefore, the finding of patent misuse was improper on these grounds as well.

The Federal Circuit also identified an additional fundamental problem with the ITC's analysis. The court noted, as technology developed, patents that were once essential, could become nonessential. Thus, under the ITC's analysis, agreements could be drafted, which, at their inception, were perfectly legitimate, but over time, became patent misuse. The court felt that for this additional reason, the ITC's decision should be reversed.

Finally, the Federal Circuit also analyzed whether Philips' licensing practices constituted patent misuse under a "rule of reason" standard, as the ITC had also held. The court found the ITC's decision to be flawed on two counts. First, it was based on an alleged anticompetitive effect to competitors of the "nonessential patents," when, as the Federal Circuit had previously noted, there were no commercially viable alternatives. Second, the ITC did not analyze the efficiencies offered by package licensing. Therefore, the court reversed the ITC's holding on this ground as well.

ONE YEAR COVENANT NOT TO COMPETE IN THE SOUTHEAST IS ENFORCEABLE AGAINST SALES REPRESENTATIVE

Businesses sometimes require key employees to agree not to work for competitors or otherwise compete with them for a period after their employment is terminated. In *Emerson Electric Co. v. Rogers*, No. 05-1441 (8th Cir. August 8, 2005), the Court of Appeals for the Eighth Circuit found that a covenant not to compete was enforceable against a sales representative to prevent that representative from selling a competitor's products, and affirmed the grant of an injunction against the sales representative, finding that the covenant was not so broad as to be unenforceable.

This case involved a sales representative, Guy Rogers, who sold ceiling fans to retailers in the Southeast. In 1988, Rogers began selling Emerson Electric fans to various retailers. At that time, he was also selling lighting products made by Minka. In 1994, Minka began selling ceiling fans, and requested that Rogers handle their account. Rogers declined at that time. In 1997, Emerson asked Rogers to sign a covenant not to compete. In 1999, Rogers signed a second copy of the covenant not to compete. Under the covenant, Rogers was obligated not to sell competitive products for a period of one year after termination of his relationship with Emerson.

In 2004, Rogers ended his relationship with Emerson. At the time, he was concerned that Minka was going to replace him as their lighting sales representative, if he did not begin selling their ceiling fans as well. Almost immediately after termination of his relationship with Emerson, Rogers began speaking with his contacts at certain retailers regarding the sale of Minka fans. In 2004, Emerson filed suit against Rogers alleging breach of the covenant not to compete and trade secret violations and seeking a temporary restraining order. The district court granted Emerson's motion for a temporary restraining order and

later entered a preliminary injunction. The injunction enjoined Rogers and his agents from selling ceiling fans competitive with Emerson for one year from the end of his employment in the southeast. Rogers appealed seeking to hold the covenant not to compete unenforceable.

The Eighth Circuit, applying Missouri law, held that the covenant was enforceable. The court stated that Missouri law required a covenant not to compete to meet two requirements for enforceability. One, it must protect well-recognized employer interests, and two, it must be reasonable in geographic and temporal scope. The court held that Emerson's interest in protecting its relationships with customers was sufficient to require the protection sought. Specifically, even though Rogers had worked for Minka even while employed by Emerson, his success as a sales representative showed that he had special influence over Emerson's customers. Moreover, during the course of his affiliation with Emerson, he acquired knowledge regarding its sales, marketing, and pricing practices that Emerson could legitimately seek to restrain from being used to lure away its customers.

Finally, the court also found that the covenant was not overbroad. The court held that a one-year restriction limited to the Southeast was a reasonable restriction to protect Emerson's interests. Therefore, the court affirmed the Eighth Circuit's award of an injunction.

LICENSEE IN GOOD STANDING CANNOT BRING ACTION TO CHALLENGE THE VALIDITY AND ENFORCEABILITY OF THE LICENSED PATENT

U.S. courts only have jurisdiction over actual cases and controversies. They do not render advisory opinions. Therefore a party may bring a lawsuit to enforce its rights against another party, or a concerned party that has a reasonable apprehension of being sued may bring a declaratory judgment lawsuit against the other party. However, if the concerned party has no reasonable apprehension of being sued, the Court will dismiss the lawsuit, finding that there is no actual controversy sufficient for it to take jurisdiction over the case.

In *Medimmune, Inc. v. Genentech, Inc.*, No. 04-1300, -1384 (Fed. Cir. October 18, 2005), the Court of Appeals for the Federal Circuit held that a licensee who continues to meet its obligations under a license agreement does not have reasonable apprehension of being sued by the licensor, and therefore cannot bring a declaratory judgment action to invalidate the licensed patent. The court found there was no actual controversy sufficient to support the exercise of jurisdiction over such an action when a licensee continued in good standing under the license agreement.

The patented technology in this case related to the use of cell cultures to manufacture human antibodies. Genentech and a third party, Celltech, were involved in a patent interference proceeding lasting over seven years relating to the patented technology. The parties eventually settled their dispute and entered into a cross-licensing agreement providing for the sharing of royalties. Medimmune had a license under the patents owned by both parties that

were involved in the interference. After final resolution of the interference, Medimmune's license also extended to the patent, which ultimately issued from the interference. When this patent issued, Genentech asserted that certain Medimmune products were covered by the license. Medimmune objected and filed a declaratory judgment action for patent invalidity and unenforceability. Medimmune, however, continued to pay the royalties due to Genentech. The district court dismissed the suit for lack of an actual controversy, holding that unless Medimmune had a reasonable apprehension of suit, it could not maintain this action. Since Medimmune continued to be a licensee in good standing, the court found that no apprehension of suit could exist and dismissed the case. Medimmune appealed.

On appeal, Medimmune admitted that it did not have a reasonable apprehension of suit, but argued that under the Supreme Court decision in *Lear v. Adkins*, it had an absolute right to challenge the validity of a patent. *Lear v. Adkins* had abolished the contract doctrine of licensee estoppel, which provided that a licensee could not challenge the validity of a licensed patent. The Federal Circuit held that *Lear* did not apply to this case because Medimmune was a licensee in good standing. In *Lear*, the licensee had defaulted and was subject to suit for infringement. In the present case, there was no possibility of suit. Moreover, the court noted that the issue was not one of licensee estoppel but rather jurisdiction. The Federal Circuit stated that the imbalance of allowing a licensee to both maintain its license and challenge the validity of a patent "distorts the equalizing principles that underlie the Declaratory Judgment Act." Therefore, there was no jurisdiction over Medimmune's action for invalidity.

In addition to its patent claims, Medimmune also argued that Genentech violated state and federal antitrust laws through its interference settlement with Celltech. Medimmune argued that the parties improperly agreed to grant one patent priority solely because it would expire later and not because it was actually invented first. The Federal Circuit held that the settlement of priority in an interference is not a presumptive violation of antitrust laws absent a showing of market power and other antitrust predicates. Therefore, the Federal Circuit dismissed these claims as well.

CLICK-WRAP AGREEMENT PREVENTING REVERSE ENGINEERING OF SOFTWARE IS ENFORCEABLE

Software owners try to prevent illegal copying of their software by attempting to have the buyers of the software accept conditions for using the software when they open the wrapper of the software (shrink-wrap agreement) or when they click their agreement on the computer prior to using the software (click-wrap agreement).

In *Davidson & Associates v. Jung*, No. 04-3654, (8th Cir. Sept. 1, 2005), the Court of Appeals for the Eighth Circuit held that a computer game purchaser's reverse engineering of a software game in order to provide an alternative on-line gaming service was a violation of the click-wrap

agreement entered into upon purchase and use of the software, and held that the terms of an end-user software license prohibiting reverse engineering were enforceable against the end-user.

This case related to several video games sold by the plaintiff. In addition to the games, the plaintiff had established an on-line gaming service for users of the game to play each other on-line. The plaintiff had also taken certain steps to avoid illegal copying of its software. Upon first use of the software, an end-user is required to "click" its agreement to the Terms of Use and End User License Agreement accompanying the software. Both of these agreements prohibited reverse engineering. In addition, users were required to enter a key word provided with the software in order to utilize the software. Finally, in order to play the game on-line, the on-line site performed a check to make sure that the software was authorized.

Due to certain frustrations with the on-line service offered by plaintiffs, a group of volunteer computer gamers, including several of the defendants, developed a program that emulated the on-line service provided by plaintiffs. This program was offered for free. In order to create this program, the defendants reverse engineered the software to ensure that their on-line service would work with the video games. In addition, the defendants' game disabled the on-line function that checked for authenticity of the software. Thus, their on-line service could be used with pirated copies of the software. The plaintiffs brought several claims against the defendants including claims for breach of the Terms of Use and End User License Agreement. The district court granted summary judgment to the plaintiffs on this claim and defendants appealed.

On appeal, the Eighth Circuit first analyzed whether federal copyright law preempted the state law claims for breach of contract. The court held that in order for preemption to apply in this circumstance, it must be impossible to comply with both the federal and state laws or the state law must stand as an obstacle to the accomplishment and execution of the federal laws. The defendants argued that federal copyright law permits reverse engineering and therefore, this right could not be restricted by state law contracts. The Eighth Circuit held that the contracts at issue did not conflict with federal copyright law. In the court's view, the defendants had freely contracted to waive their right to reverse engineer the software and a state can permit a party to contract away uses that are permitted under federal law. Since the defendants expressly waived their right to reverse engineer, by doing so, they breached these agreements. Therefore, the court affirmed the grant of summary judgment.

A PATENT OWNER WHO SAID IT DID NOT OBJECT TO ITS CUSTOMER USING A THIRD PARTY SUPPLIER OF ITS PATENTED PRODUCT IS NOT ESTOPPED FROM ASSERTING ITS PATENT CLAIM AGAINST THE CUSTOMER

In *Sunbeam Products, Inc. v. Wing Shing Products (BVI) Ltd.*, No. 04-1526, -1527 (Fed. Cir. August 24, 2005), the

Court of Appeals for the Federal Circuit reviewed a case having several issues relating to the development and patenting of a coffee maker design and made the following findings: (1) a customer who worked with its manufacturer to design a product could be sued for infringement if it was not a joint inventor of that product; (2) a patent owner who said it did not object to its customer using a third party supplier of its patented product is not estopped from asserting its patent infringement claim against the customer; and (3) any claims for breach of a contract that required negotiation of the ownership of any jointly developed patent rights before filing an application could not be raised because they allowed too much time to pass before asserting the claim for breach and were therefore barred by the statute of limitations.

This case related to certain coffee makers manufactured by Wing Shing and sold by Sunbeam. In 1991, Wing Shing and Sunbeam's predecessor Mr. Coffee entered into communications regarding the supply of coffee makers by Wing Shing to Mr. Coffee. During the course of their talks, Wing Shing provided a proposed design to Mr. Coffee. Mr. Coffee proposed numerous modifications to the design before agreeing on a final model. At that time, the parties entered into an agreement that provided that any and all existing patent rights would be owned by Mr. Coffee, and that the parties would negotiate patent rights before applying for a patent on a jointly developed patented items.

For several years, Wing Shing supplied coffee makers to Mr. Coffee. Unbeknownst to Mr. Coffee, Wing Shing filed for a design patent on the coffee maker design. This patent was eventually granted to Wing Shing. In 1994, Mr. Coffee sent a notice to Wing Shing that it was moving some of its business to a third party. In response, in 1995, Wing Shing informed Mr. Coffee that it had a design patent on the coffee maker, but that it had no objection to Mr. Coffee using a third party to manufacture the coffee makers. In 2000, Sunbeam purchased Mr. Coffee and dramatically reduced the number of coffee makers being purchased from Wing Shing. Thereafter, Sunbeam entered bankruptcy. Wing Shing sued in the bankruptcy court for patent infringement. In response, Sunbeam argued that it was a joint inventor of the patents, that Wing Shing had breached its contract by filing an application before negotiating ownership with Sunbeam, and that Wing Shing should be equitably estopped from asserting the patent.

The bankruptcy court found that Sunbeam was not a joint inventor of the design patent, and that Wing Shing did not breach its obligations under the agreement, but even if it did, that claim was barred by the statute of limitations. The bankruptcy court also found that Wing Shing's 1995 letter informing Sunbeam that it did not object to Sunbeam using a third party supplier did not mislead Sunbeam into believing it would never be sued for infringement. Therefore, Sunbeam could not rely on the defense of equitable estoppel. On appeal, the district court agreed that Sunbeam was not a joint inventor. The court, however, found that Wing Shing did breach its obligations under the agreement finding that even if Sunbeam was not a joint inventor, it was a joint developer within the meaning of the contract. The court, however, held that this claim was barred by the statute of limitations. The court also agreed that Wing Shing's claims were not barred by equitable estoppel. Sunbeam appealed these rulings to the Federal Circuit.

On appeal, the Federal Circuit affirmed the finding that Sunbeam was not a joint inventor of the patent. The court held that its contributions were not significant in light of the limited and mainly functional nature of the proposed design changes. The court also agreed that the statute of limitations barred Sunbeam's breach of contract claim. The Federal Circuit held that it was undisputed that Sunbeam learned of the alleged breach of contract in 1995 and that the statute of limitations was 3 years. Therefore, the limitations period expired in 1998. The court declined to reach the issue of whether or not Sunbeam was a joint developer within the meaning of the contract.

Sunbeam also argued that Wing Shing should be equitably estopped from asserting its patent because of the 1995 letter in which it stated it had no objection to Sunbeam using another supplier. In response, Wing Shing submitted evidence that tended to show that this letter did not mislead Sunbeam, and that in internal communications expressed concern that the design patent would in fact be an issue. The Federal Circuit held that while the evidence submitted was open to multiple interpretations, the bankruptcy court did not commit clear error in finding that Sunbeam was not misled into believing that Wing Shing would never enforce its patent against Sunbeam. Therefore, the Federal Circuit also held that Wing Shing was not equitably estopped from asserting its patent infringement claims.